

of the trust, and any condition governing the time when a distribution to him may be made, such as a specific date or age (or in lieu of such statement a copy of the trust instrument which must be attached to the return);

(10) A detailed list of the property transferred to the foreign trust in the transaction for which the return is being filed, containing a complete description of each item transferred, its adjusted basis and its fair market value on the date transferred, and the consideration, if any, paid by the foreign trust for such transfer; and

(11) The name and address of the person (or persons) having custody of the books of account and records of the foreign trust, and the location of such books and records if different from such address.

(d) *Special provisions*—(1) *Separate return for each foreign trust and each transfer*. If a United States person creates more than one foreign trust or transfers money or property to more than one foreign trust, then separate returns must be filed with respect to each foreign trust where returns are required under section 6048 and this section. If a United States person transfers money or property to the same foreign trust at different times, then separate returns must be filed with respect to each transfer where returns are required under section 6048 and this section. However, where more than one transfer to the same foreign trust is made by a United States person during any 90-day period, such person may, at his election, file a single return, so long as the return includes the information required with respect to each transfer and is filed on or before the 90th day after the earliest transfer in any such period.

(2) *Joint returns*. Where returns are required under section 6048 and this section by two or more persons who either jointly create a foreign trust or jointly transfer money or property to a foreign trust, they may jointly execute and file one return in lieu of filing several returns.

(3) *Actual ownership of money or property transferred*. If any person referred to in this section is not the real party in interest as to the money or property transferred but is merely acting for a

United States person, the information required under this section shall be furnished in the name of and by the actual owner of such money or property, except that a fiduciary of an estate shall file information relating to the decedent.

(4) *Payments to an employees' trust, etc.* In the case of contributions made to a foreign trust under a plan which provides pension, profit-sharing, stock bonus, sickness, accident, unemployment, welfare, or similar benefits or a combination of such benefits for employees, neither employers nor employees shall be required to file a return as set forth in this section.

(e) *Time and place for filing return*—(1) *Time for filing*. Any return required by section 6048 and this section shall be filed on or before the 90th day after either the creation of any foreign trust by a United States person or the transfer of any money or property to a foreign trust by a United States person. The Director of International Operations is authorized to grant reasonable extensions of time to file returns under section 6048 and this section in accordance with the applicable provisions of section 6081(a) and §1.6081-1.

(2) *Place for filing*. Returns required by section 6048 and this section shall be filed with the Director of International Operations, Internal Revenue Service, Washington D.C. 20225.

(f) *Penalties*—(1) *Criminal*. For criminal penalties for failure to file a return see section 7203. For criminal penalties for filing a false or fraudulent return, see sections 7206 and 7207.

(2) *Civil*. For civil penalty for failure to file a return or failure to show the information required on a return under this section, see section 6677.

[T.D. 6632, 28 FR 277, Jan. 10, 1963]

PART 16A—TEMPORARY INCOME TAX REGULATIONS RELATING TO THE PARTIAL EXCLUSION FOR CERTAIN CONSERVATION COST-SHARING PAYMENTS

Sec.

16A.126-0 Effective dates.

16A.126-1 Certain cost-sharing payments—in general.

16A.126-2 Section 126 elections.

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16A.1255-1 General rule for treatment of gain from disposition of section 126 property.

16A.1255-2 Special rules.

AUTHORITY: Secs. 126 and 7805 of the Internal Revenue Code of 1954 (92 Stat. 2888, 26 U.S.C. 126; 68A Stat. 917, 26 U.S.C. 7805).

SOURCE: T.D. 7778, 46 FR 27637, May 21, 1981, unless otherwise noted.

§ 16A.126-0 Effective dates.

These temporary regulations shall apply to any payments received under a contract signed by the taxpayer and the appropriate agency after September 30, 1979.

§ 16A.126-1 Certain cost-sharing payments—in general.

(a) *Introduction.* In general, section 126 provides that recipients of payments made after September 30, 1979 under certain conservation, reclamation and restoration programs may exclude all or a portion of those payments from income if the payments do not substantially increase the annual income derived by the taxpayer from the affected property. For purposes of this section, the term “payment” as used in section 126 means payment of the economic benefit, if any, conferred upon the taxpayer upon receipt of the improvement. An increase in annual income is substantial if it exceeds the greater of 10 percent of the average annual income derived from the affected property prior to receipt of the improvement or an amount equal to \$2.50 times the number of affected acres. The amount of gross income which a taxpayer realizes upon the receipt of a section 126 payment is the value of the section 126 improvement, reduced by the sum of the excludable portion and the taxpayer’s share of the cost of the improvement (if any).

(b) *Definitions.* For purposes of this section, the term:

(1) “Cost of the improvement” means the sum of amounts paid by a government and the taxpayer, whether or not with borrowed funds, for the improvement.

(2) “Section 126 cost” means the cost of the improvement less the sum of

(i) Any government payments under a program which is not listed in section 126(a),

(ii) Any portion of a government payment under a program which is listed in section 126(a) which the Secretary of Agriculture has not certified is primarily for purposes of conservation,

(iii) Any government payment to the taxpayer which is in the nature of rent or compensation for services.

(3) “Value of the section 126 improvement” means the fair market value of the improvement multiplied by a fraction, the numerator of which is the section 126 cost and the denominator of which is the cost of the improvement.

(4) “Affected acreage” means the acres affected by the improvement.

(5) “Excludable portion” means the present fair market value of the right to receive annual income from the affected acreage of the greater of 10 percent of the prior average annual income from the affected acreage or \$2.50 times the number of affected acres.

(6) “Prior average annual income” means the average of the gross receipts from the affected acreage for the last three taxable years preceding the taxable year in which installation of the improvement is commenced.

(7) “Section 126 improvement” means the portion of the improvement equal to the percentage which government payments made to the taxpayer, which the Secretary of Agriculture has certified were made primarily for the purpose of conservation, bear to the cost of the improvement.

(c) *Income realized upon receipt of a section 126 improvement—(1) Section 126 exclusion applied.* Unless a taxpayer elects not to have section 126 apply, the amount of gross income realized on receipt of the section 126 improvement is the value of the section 126 improvement less the sum of the taxpayer’s share of the cost of the improvement and the excludable portion.

(2) *Section 126 exclusion not applied.* If a taxpayer elects under section 126(c) not to have section 126 apply in whole or in part, the amount realized on the receipt of the section 126 improvement is the value of the section 126 improvement less the sum of the taxpayer’s share of the cost of the improvement and the excludable portion that applies, if any.

(d) *Payments under watershed programs—(1) Programs within section*

126(a)(9). Section 126(a)(9) covers certain programs affecting small watersheds.

These programs must be administered by the Secretary of Agriculture and be determined by the Commissioner to be substantially similar to the type of program described in section 126(a) (1) through (8). The Commissioner has determined that section 126 improvements made in connection with small watersheds are within the scope of section 126(a)(9) if they are made under one of the following programs:

(A) The Watershed Protection and Flood Prevention Act, Pub. L. 566, 68 Stat. 666, as amended (16 U.S.C. 1001, *et seq.*), as funded by the Act of November 9, 1979, Pub. L. 96-108, 93 Stat. 834.

(B) Flood Prevention Projects, Pub. L. 86-468, sec. 1, 74 Stat. 131, as amended (16 U.S.C. 1006a); Pub. L. 78-534, sec. 2, 58 Stat. 889 (33 U.S.C. 701a-1); Pub. L. 78-534, sec. 13, 58 Stat. 905;

(C) Emergency Watershed Protection, Pub. L. 81-516, sec. 216, 64 Stat. 184 (33 U.S.C. 701b-1), and

(D) Colorado River Basin Salinity Control Act, Pub. L. 93-320, 88 Stat. 266:

(1) Title 1—Programs downstream from Imperial Dam, and

(2) Title 2—Measures upstream from Imperial Dam.

(2) *Other programs.* The Commissioner may announce further determinations under section 126(a)(9) from time to time in the Internal Revenue Bulletin.

(3) *Small watershed defined.* A watershed is a “small watershed” under this paragraph and section 126(a)(9) if the watershed or subwatershed does not exceed 250,000 acres and does not include any single structure providing more than 12,500 acre-feet of floodwater detention capacity, nor more than 25,000 acre-feet of total capacity.

(e) *Basis of property not increased by reason of excludable amounts.* Notwithstanding any provision of section 1016 (relating to adjustments to basis) to the contrary, basis of any property does not include any amount which is excludable from gross income under section 126.

(f) *Cross reference.* For rules relating to the recapture as ordinary income of the gain from the disposition (within 20 years of the date of receipt) of property for which an exclusion is claimed for a

section 126 improvement, see section 1255 and the regulations thereunder.

(g) *Examples.* The provisions of this section are illustrated by the following examples:

Example (1). In 1981, 100 acres of the taxpayer's land is reclaimed under a Rural Abandoned Mine Program contract with the Soil Conservation Service of the U.S. Department of Agriculture. The total cost of the improvement is \$700,000. USDA pays \$690,000, the taxpayer \$10,000. The Secretary of Agriculture certifies that 95% of the \$690,000 USDA payment was primarily for the purpose of conservation. Therefore, \$34,500 (\$690,000×.05) is a nonsection 126 payment. \$150,000 of USDA's payment is compensation for the taxpayer's service in the reclamation project and is includable in gross income as compensation for services. The taxpayer has \$20,000 of allowable deductions in 1981, \$15,500 of which are properly attributable to the USDA payment. Based on all the facts and circumstances, the value of the improvement is \$21,000. The taxpayer elects not to have section 126 apply. The taxpayer computes the amount which is included in gross income as a result of receipt of the improvement as follows:

(1)	
Cost of improvement	\$700,000
Nonsection 126 payment	(34,500)
Compensation for services	(150,000)
Current deductions	(15,500)
Section 126 cost	500,000
(2)	
Value of improvement	21,000
Multiplied by section 126 cost	×500,000
Cost of improvement	700,000
Value of section 126 improvement	15,000
(3)	
Value of section 126 improvement	15,000
(Taxpayer's contribution)	10,000
Amount included in gross income	5,000

Example (2). The facts are the same as example (1) except that section 126 applies. Based on all the facts and circumstances, the present fair market value of the right to receive annual income from the property of 10 percent of the prior average annual income of the affected acreage prior to the receipt of the improvement is \$1,380 and the present fair market value of the right to receive \$250 (\$2.50×100 acres) is \$1,550. The excludable portion is, therefore, \$1,550. The taxpayer computes the amount included in gross income as follows:

Value of section 126 improvement	\$15,000
(Taxpayer's contribution)	(10,000)
(Excludable portion)	(1,550)

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Amount included in income	3,450
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Example (3). The facts are the same as example (2) except that the present value of 10 percent of the prior average annual income is \$5,600. The taxpayer realizes no income as a result of receipt of the section 126 project.

(1)

Value of section 126 improvement	\$15,000
(Taxpayer's contribution)	(10,000)
(Excludable portion)	(5,600)

Amount included in income	0
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Example (4). In 1983, the taxpayer signs a contract under the water bank program under which he will maintain 20 acres of undisturbed wetlands as a wildfowl preserve. In return he will receive \$90 an acre as rent from the government. Although the payment is made under a program listed in section 126(a) and the Secretary of Agriculture has certified that the entire amount of payment was made primarily for the purpose of conservation, there is no income eligible for section 126 exclusion because the full payment is rent. The rent is included in full in gross income.

Example (5). In 1980, the taxpayer reforests 200 acres of nonindustrial private forest land by planting tree seedlings. The taxpayer pays the full cost of the reforestation, \$15,000. Under the cost-sharing provisions of the forestry incentives program, the taxpayer receives a reimbursement from USDA of \$12,000. The Secretary of Agriculture certifies that 100% of the USDA payment is primarily for the purpose of conservation. Assume that the excludable portion is \$3,500 and that based on all the facts and circumstances, the value of the improvement is \$15,000. The amount which is includable in income is the value of the section 126 improvement, reduced by the excludable portion and the taxpayer's share of the cost of the improvement. Therefore the taxpayer includes \$8,500 in gross income as a result of the USDA payment, computed as follows:

Value of the section 126 improvement	\$15,000
(Excludable portion)	(3,500)
(Taxpayer's contribution)	(3,000)

Amount included in gross income	8,500
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[T.D. 7748, 46 FR 27637, May 21, 1981; 46 FR 41043, Aug. 14, 1981]

§ 16A.126-2 Section 126 elections.

(a) *Election for section 126 not to apply in whole or in part.* A taxpayer may elect under section 126(c) not to have section 126 apply to all or any part of an improvement described in section 126.

(b) *Application of the section 126 exclusion.* To the extent the section 126 exclusion applies, the taxpayer should so

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indicate on an attachment to the tax return (or amended return) for the taxable year in which the taxpayer received the last payment made by a government for the improvement. The attachment should state the dollar amount of the section 126 cost funded by a government payment, the value of the section 126 improvement, and the amount that the taxpayer is excluding under section 126.

§ 16A.1255-1 General rule for treatment of gain from disposition of section 126 property.

(a) *Ordinary income*—(1) *General rule.* Except as otherwise provided in this section and § 16A.1255-2, if section 126 property is disposed of after September 30, 1979, then under section 1255(a)(1) there shall be recognized as ordinary income the lesser of—

(i) The “excludable portion” under section 126, or

(ii)(A) The excess of the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of the section 126 property (in the case of any other disposition), over the adjusted basis of the property, less

(B) The amount recognized as ordinary income under the other provisions of Chapter I, Subchapter P, Part IV of the Code.

(2) *Application of section.* Any gain treated as ordinary income under section 1255(a)(1) shall be recognized as ordinary income notwithstanding any other provision of subtitle A of the Code except that section 1255 does not apply to the extent the gain is recognized as ordinary income under the other provisions of Subchapter P, Part IV of the Code. For special rules with respect to the application of section 1255, see § 16A.1255-2. For the relation of section 1255 to other provisions, see paragraph (c) of this section.

(3) *Meaning of terms.* For purposes of section 1255 and these regulations—

(i) The term “section 126 property” means any property acquired, improved, or otherwise modified as a result of a payment listed in section 126(a) which has been certified by the Secretary of Agriculture as primarily for the purpose of conservation;

(ii) The term “excludable portion” is defined in § 16A.126-1(b)(5);

(iii) The term “disposition” has the same meaning as in § 1.1245-1(a)(3);

(iv) The term “date of receipt of the section 126 payment” means the last date the government made a payment for the improvements.

(4) *Applicable percentage.* If section 126 property is disposed of less than 10 years after the date of receipt of the last payment which has been certified by the Secretary of Agriculture as primarily for the purpose of conservation, the “applicable percentage” is 100 percent; if section 126 property is disposed of more than 10 years after that date, the applicable percentage is 100 percent reduced (but not below zero) by 10 percent for each year or part thereof in excess of 10 years such property was held after the date of the section 126 payment.

(5) *Portion of parcel.* The amount of gain to be recognized as ordinary income under section 1255(a)(1) shall be determined separately for each parcel of section 126 property in a manner consistent with the principles of § 1245-1(a) (4) and (5) relating to gain from disposition of certain depreciable property. If (i) only a portion of a parcel of section 126 property is disposed of in a transaction, or if two or more portions of a single parcel are disposed of in one transaction, and (ii) the aggregate of “excludable portions” with respect to any such portion cannot be established to the satisfaction of the Commissioner, then the aggregate of the “excludable portions” in respect of the entire parcel shall be allocated to each portion in proportion to the fair market value of each at the time of the disposition.

(b) *Instances of nonapplication*—(1) *In general.* Section 1255 does not apply if a taxpayer disposes of section 126 property more than 20 years after receipt of the last section 126 payment with respect to the property.

(2) *Losses.* Section 1255(a)(1) does not apply to losses. Thus, section 1255(a)(1) does not apply if a loss is realized upon a sale, exchange, or involuntary conversion of property, all of which is section 126 property, nor does the section apply to a disposition of the property other than by way of sale, exchange, or

involuntary conversion if at the time of the disposition the fair market value of the property is not greater than its adjusted basis.

(c) *Relation of section 1255 to other provisions*—(1) *General.* The provisions of section 1255 apply notwithstanding any other provisions of Subtitle A of the Code except that they do not apply to the extent gain is recognized as ordinary income under the other provisions of Subchapter P, Part IV of the Code. Thus, unless an exception or limitation under § 16A.1255-2 applies, gain under section 1255(a)(1) is recognized notwithstanding any contrary nonrecognition provision or income characterizing provision. For example, since section 1255 overrides section 1231 (relating to property used in the trade or business), the gain recognized under section 1255 upon a disposition of section 126 property will be treated as ordinary income and only the remaining gain, if any, from the disposition may be considered as gain from the sale or exchange of property to which section 1231 applies. See example (1) of paragraph (d) of this section.

(2) *Nonrecognition sections overridden.* The nonrecognition of gain provisions of Subtitle A of the Code which section 1255 overrides include, but are not limited to, sections 267(d), 311(a), 336, 337, and 512(b)(5). See § 16A.1255-2 for the extent to which section 1255(a)(1) overrides sections 332, 351, 361, 371(a), 374(a), 721, 731, 1031, and 1033.

(3) *Installment method.* Gain from a disposition to which section 1255(a)(1) applies may be reported under the installment method if such method is otherwise available under section 453 of the Code. In such a case, the portion of the installment payment that is gain is treated as follows: first as ordinary gain under other sections of Chapter I Subchapter P, Part IV of the Code until all that gain has been reported; next as ordinary gain to which section 1255 applies until all that gain is reported; and finally as gain under other sections of Chapter I, Subchapter D, Part IV of the Code. For treatment of amounts as interest on certain deferred payments, see section 483.

(4) *Exempt income.* With regard to exempt income, the principles of § 1.1245-6(e) shall be applicable.

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(5) *Treatment of gain not recognized under section 1255(a)(1).* For treatment of gain not recognized under this section, the principles of § 1.1245-6(f) shall be applicable.

(d) *Example.* The provisions of this section may be illustrated by the following example:

Example. Individual A uses the calendar year as his taxable year. On April 10, 1995, A sells for \$75,000 section 126 property with an adjusted basis of \$52,500 for a realized gain of \$22,500. The excludable portion under section 126 was \$18,000. A received the section 126 payment on January 5, 1990. No gain is recognized as ordinary gain under sections 1231 through 1254. Because the applicable percentage, 100 percent, of the aggregate of the section 126 improvements (\$18,000), \$18,000, is lower than the gain realized, \$22,500, the amount of gain recognized as ordinary income under section 1255(a)(1) is \$18,000. The remaining \$4,500 of the gain may be treated as gain from the sale or exchange of property described in section 1231.

§ 16A.1255-2 Special rules.

(a) *Exception for gifts—(1) General rule.* In general, no gain shall be recognized under section 1255(a)(1) upon a disposition of section 126 property by gift. For purposes of section 1255 and this paragraph, the term “gift” shall have the same meaning as in § 1.1245-4(a) and, with respect to the application of this paragraph, principles illustrated by the examples of § 1.1245-4(a)(2) shall apply.

(2) *Disposition in part a sale or exchange and in part a gift.* Where a disposition of section 126 property is in part a sale or exchange and in part a gift, the amount of gain which shall be recognized as ordinary income under section 1255(a)(1) shall be computed under § 16A.1255-1(a)(1), applied by treating the gain realized (for purposes of § 16A.1255-1(a)(1)(ii)), as the excess of the amount realized over the adjusted basis of the section 126 property.

(3) *Treatment of section 126 property in hands of transferee.* See paragraph (d) of this section for treatment of the transferee in the case of a disposition to which this paragraph applies.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). On March 2, 1986, A makes a gift to B of a parcel of land having an adjusted basis of \$40,000 and fair market value

of \$65,000. On the date of that gift, the aggregate of excludable portions under section 126 was \$24,000. The section 126 payments were all received on January 15, 1981. Upon making the gift, A recognizes no gain under section 1255(a)(1). See paragraph (a)(1) of this section. For treatment of the property in the hands of B, see example (1) of paragraph (d)(3) of this section.

Example (2). (i) Assume the same facts as in example (1), except that A transfers the land to B for \$50,000. Assume further that no gain is recognized as ordinary income under any other provision of Chapter I, Subchapter P, Part IV of the Code. Thus, the gain realized is \$10,000 (amount realized, \$50,000, minus adjusted basis, \$40,000), and A has made a gift of \$15,000 (fair market value, \$65,000, minus amount realized, \$50,000).

(ii) Upon the transfer of the land to B, A recognizes \$10,000 as ordinary income under section 1255(a)(1), computed under paragraph (a)(2) of this section as follows:

(1) Aggregate of excludable portions under section 126	\$24,000
(2) Multiply: Applicable percentage for land disposed if within sixth year after section 126 payments were received	100
(3) Amount in § 16A.1255-1(a)(1)(i)	\$24,000
(4) Gain realized (see (i) of this example)	10,000
(5) Amount in § 16A.1255-1(a)(1)(ii) applied in accordance with paragraph (a)(2) of this section	10,000
(6) Lower of line (3) or line (5)	10,000

Thus, the entire gain realized on the transfer, \$10,000, is recognized as ordinary income.

For treatment of the farm land in the hands of B, see example (2) of paragraph (d)(3) of this section.

(b) *Exception for transfer at death—(1) In general.* Except as provided in section 691 (relating to income in respect of a decedent), no gain shall be recognized under section 1255(a)(1) upon a transfer at death. For purposes of section 1255 and this paragraph, the term “transfer at death” shall have the same meaning as in § 1.1245-4(b) and, with respect to the application of this paragraph, principles illustrated by the examples of § 1.1245-4(b)(2) shall apply.

(2) *Treatment of section 126 property in hands of transferee.* If, as of the date a person acquires section 126 property from a decedent, the person's basis is determined by reason of the application of section 1014(a), solely by reference to the fair market value of the property on the date of the decedent's death, or on the applicable date provided in section 2032 (relating to alternative valuation date), then on that

date the aggregate of excludable portions under section 126 in the hands of such transferee is zero.

(c) *Limitation for certain tax-free transactions*—(1) *Limitation on amount of gain*. Upon a transfer of section 126 property described in paragraph (c)(2) of this section, the amount of gain recognized as ordinary income under section 1255(a)(1) shall not exceed an amount equal to the excess (if any) of (i) the amount of gain recognized to the transferor on the transfer (determined without regard to section 1255) over (ii) the amount (if any) of gain recognized as ordinary income under the other provisions of Chapter I, Subchapter P, Part IV of the Code. For purposes of paragraph (c)(1) of this section, the principles of § 1.1245-4(c)(1) shall apply. Thus, in the case of a transfer of section 126 property and other property in one transaction, the amount realized from the disposition of the section 126 property (as determined in a manner consistent with the principles of § 1.1245-1(a)(5)) shall consist of that portion of the fair market value of each property acquired which bears the same ratio to the fair market value of the acquired property as the amount realized from the disposition of the section 126 property bears to the total amount realized. The preceding sentence shall be applied solely for purposes of computing the portion of the total gain (determined without regard to section 1255) which is eligible to be recognized as ordinary income under section 1255(a)(1). The provisions of this paragraph do not apply to a disposition of property to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by Chapter I of the Code.

(2) *Transfers covered*. The transfers referred to in paragraph (c)(1) of this section are transfers of section 126 property in which the basis of the property in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of any of the following provisions:

(i) Section 332 (relating to distributions in complete liquidation of an 80-percent-or-more controlled subsidiary corporation). For application of paragraph (c)(1) of this section to such a

complete liquidation, the principles of § 1.1245-4(c)(3) shall apply. Thus, for example, the provisions of paragraph (c)(1) of this section do not apply to a liquidating distribution of section 126 property by an 80-percent-or-more controlled subsidiary to its parent if the parent's basis for the property is determined, under section 334(b)(2), by reference to its basis for the stock of the subsidiary.

(ii) Section 351 (relating to transfer to a corporation controlled by the transferor).

(iii) Section 361 (relating to exchanges pursuant to certain corporate reorganizations).

(iv) Section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings).

(v) Section 374(a) (relating to exchanges pursuant to certain railroad reorganizations).

(vi) Section 721 (relating to transfers to a partnership in exchange for a partnership interest). See paragraph (e) of this section.

(vii) Section 731 (relating to distributions by a partnership to a partner). For special carryover of basis rule, see paragraph (e) of this section.

(viii) Section 1031 (relating to like kind exchanges).

(ix) Section 1034 (relating to rollover of gain on the sale of a principal residence).

(3) *Treatment of section 126 property in the hands of transferee*. See paragraph (d) of this section for treatment of the transferee in the case of a disposition to which this paragraph applies.

(4) *Examples*. The provisions of this paragraph may be illustrated by the following examples:

Example (1). On January 4, 1986, A holds a parcel of property that is section 126 property having an adjusted basis of \$15,000 and a fair market value of \$40,000. On that date he transfers the parcel to corporation M in exchange for stock in the corporation worth \$40,000 in a transaction qualifying under section 351. On the date of the transfer, the aggregate of excludable portions under section 126 with respect to the transferred property is \$18,000 and all of such amount was received on March 25, 1981. With regard to section 1255, A would recognize no gain under section 351 upon the transfer and M's basis for the land would be determined under section 362(a) by reference to its basis in the hands of A. Thus, as a result of the disposition, no

gain is recognized as ordinary income under section 1255 by A since the amount of gain recognized under that section is limited to the amount of gain which is recognized under section 351 (determined without regard to section 1255). See paragraph (c)(1) of this section. For treatment of the section 126 property in the hands of B, see paragraph (d)(1) of this section.

Example (2). Assume the same facts in example (1), except that A transferred the property to M for stock in the corporation worth \$32,000 and \$8,000 cash. The gain realized is \$25,000 (amount realized, \$40,000, minus adjusted basis, \$15,000). Without regard to section 1255, A would recognize \$8,000 of gain under section 351(b). Assume further that no gain is recognized as ordinary income under the other provisions of Chapter I, Subchapter P, Part IV of the Code. Therefore, since the applicable percentage, 100 percent of the aggregate excludable portions under section 126, \$18,000, is lower than the gain realized, \$25,000, the amount of gain to be recognized as ordinary income under section 1255(a)(1) would be \$18,000 if the provisions of paragraph (c)(1) of this section do not apply. Since under section 351(b) gain in the amount of \$8,000 would be recognized to the transferor without regard to section 1255, the limitation provided in paragraph (c)(1) of this section limits the gain taken into account by A under section 1255(a)(1) to \$8,000.

Example (3). Assume the same facts as in example (2), except that \$5,000 of gain is recognized as ordinary income under section 1251(c)(1). The amount of gain recognized as ordinary income under section 1255(a)(1) is \$3,000 computed as follows:

(1) Amount of gain under section 1255(a)(1) (determined without regard to paragraph (c)(1) of this section):	
(a) Aggregate of excludable portions under section 126	\$18,000
(b) Multiply: Applicable percentage for property disposed of within the fifth year after section 126 payments were received (percent)	100
(c) Amount in § 16A.1255-1(a)(1)(i)	\$18,000
(d) Gain realized (amount realized \$40,000 less adjusted basis, \$15,000)	\$25,000
(e) Lower of line (c) or line (d)	\$18,000
(2) Limitation in paragraph (c)(1) of this section:	
(a) Gain recognized (determined without regard to section 1255)	\$8,000
(b) Minus: Gain recognized as ordinary income under section 1251(c)(1)	\$5,000
(c) Difference	\$3,000
(3) Lower of line (1)(e) or line (2)(c)	\$3,000

Thus, the entire gain recognized under section 351(b) (determined without regard to sections 1251 and 1255), \$8,000, is recognized as ordinary income since that amount is equal to the sum of the gain recognized as ordinary income under section 1251(c)(1), \$5,000, and under section 1255(a)(1), \$3,000.

(d) *Treatment of section 126 property received by a transferee in a disposition by gift and certain tax-free transactions—(1) General rule.* If section 126 property is disposed of in a transaction which is either a gift to which paragraph (a)(1) of this section applies, or a completely tax-free transfer to which paragraph (c)(1) of this section applies, then for purposes of section 1255—

(i) The aggregate of the excludable portions under section 126 in respect of the land in the hands of the transferee immediately after the disposition shall be an amount equal to the amount of such aggregate in the hands of the transferor immediately before the disposition, and

(ii) For purposes of applying section 1255 upon a subsequent disposition by the transferee (including a computation of the applicable percentage), the dates of receipt of section 126 payments shall not be affected by the dispositions.

(2) *Certain partially tax-free transfers.* If section 126 property is disposed of in a transaction which either is in part a sale or exchange and in part a gift to which paragraph (a)(2) of this section applies, or is a partially tax-free transfer to which paragraph (c)(1) of this section applies, then for purposes of section 1255 the amount determined under paragraph (d)(1) of this section shall be reduced by the amount of gain taken into account under section 1255 by the transferor upon the disposition. Upon a subsequent disposition by the transferee, the dates of receipt of section 126 payments remain the same in the hands of the transferee as they were in the hands of the transferor. With respect to the 175 and 182 deductions taken by the transferee, the holding period shall not include the holding period of the transferor.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). Assume the same facts as in example (1) of paragraph (a)(4) of this section. Therefore, on the date B receives the land in the gift transaction, under paragraph (d)(1) of this section the aggregate of excludable portions under section 126 in respect of the land in the hands of B is the amount in the hands of A, \$24,000, and for purposes of applying section 1255 upon a subsequent disposition by B (including a computation of

the applicable percentage) the date the section 126 payments were received is the same as it was when the property was in A's hands (January 15, 1981).

Example (2). Assume the same facts as in example (2) of paragraph (a)(4) of this section. Under paragraph (d)(2) of this section, the aggregate of excludable portions under section 126 which pass over to B for purposes of section 1255 is \$14,000 (\$24,000 excluded under section 126 minus \$10,000 gain recognized under section 1255(d)(1) in accordance with example (2) of paragraph (a)(4) of this section). The date the section 126 payments were received is the same as when the property was in B's hands (January 15, 1981).

(e) *Disposition of section 126 property not specifically covered.* If section 126 property is disposed of in a transaction not specifically covered under § 16A.1255-1, and this section, then the principles of section 1245 shall apply.

PART 17—TEMPORARY INCOME TAX REGULATIONS UNDER 26 U.S.C. 103(c)

AUTHORITY: Sec. 7805 of the Internal Revenue Code of 1954; 68A Stat. 917 (26 U.S.C. 7805).

§ 17.1 Industrial development bonds used to provide solid waste disposal facilities; temporary rules.

(a) *In general.* Section 103(c)(4)(E) provides that section 103(c)(1) shall not apply to obligations issued by a State or local governmental unit which are part of an issue substantially all the proceeds of which are used to provide solid waste disposal facilities. Section 1.103-8(f) of this chapter provides general rules with respect to such facilities and defines such facilities. In the case of property which has both a solid waste disposal function and a function other than the disposal of solid waste, only the portion of the cost of the property allocable to the function of solid waste disposal (as determined under paragraph (b) of this section) is taken into account as an expenditure to provide solid waste disposal facilities. A facility which otherwise qualifies as a solid waste disposal facility will not be treated as having a function other than solid waste disposal merely because material or heat which has utility or value is recovered or results from the disposal process. Where mate-

rials or heat are recovered, the waste disposal function includes the processing of such materials or heat which occurs in order to put them into the form in which the materials or heat are in fact sold or used, but does not include further processing which converts the materials or heat into other products.

(b) *Allocation.* The portion of the cost of property allocable to solid waste disposal is determined by allocating the cost of such property between the property's solid waste disposal function and any other functions by any method which, with reference to all the facts and circumstances with respect to such property, reasonably reflects a separation of costs for each function of the property.

(c) *Example.* The principles of this paragraph may be illustrated by the following example:

Example. Company A intends to construct a new facility to process solid waste which City X will deliver to the facility. City X will pay a disposal fee for each ton of solid waste that City X dumps at the facility. The waste will be processed by A in a manner which separates metals, glass, and similar materials. As separated, some of such items are commercially saleable; but A does not intend to sell the metals and glass until the metals are further separated, sorted, sized, and cleaned and the glass is pulverized. The metals and pulverized glass will then be sold to commercial users. The waste disposal function includes such processing of the metals and glass, but no further processing is included.

The remaining waste will be burned in an incinerator. Gases generated by the incinerator will be cleaned by use of an electrostatic precipitator. To reduce the size and cost of the electrostatic precipitator, the incinerator exhaust gases will be cooled and reduced in volume by means of a heat exchange process using boilers. The precipitator is functionally related and subordinate to disposal of the waste residue and is therefore property used in solid waste disposal. The heat can be used by A to produce steam. Company B operates an adjacent electric generating facility and B can use steam to power its turbine-generator. B needs steam with certain physical characteristics and as a result A's boilers, heat exchanger and related equipment are somewhat more